



Armenia Country Overview



BASIC FACTS:

Capital: Yerevan
Area: 29,800 square kilometers
Population: about 3.9 million (1999)
Currency: Dram
Exchange Rate: \$1 = 556 Dram (May, 2001)
GNP: \$1.9 billion (1999)
GDP Growth: 7.2% (1998); 3.3% (1999); 5.6% (1999-03)
GNP per capita: \$490 (1999)
Inflation: 0.7 % (1999)

EXECUTIVE SUMMARY

Armenia is a small, strategically located country (land area of 29,800 square kilometers, slightly larger than Maryland) with a literate population of about 3 million. Located in the heart of the Caucasus, Armenia is bordered by Turkey to the west, Georgia to the north, Iran to the south, and Azerbaijan to the east and southwest. The Armenians have a strong tradition of education and entrepreneurship which, combined with their close ties to the U.S. through the American-Armenian Diaspora, provides attractive prospects for joint venture partners and other business linkages with U.S. companies.

Over the past few years, Armenia has successfully managed to implement a comprehensive stabilization and structural reform program. Some of the main achievements include: price liberalization; privatization of small-scale enterprises (over 7,000) and medium/large enterprises (1,800 for sale as of early 1998); and significant progress towards joining the WTO (experts believe that Armenia will become a member this year). In addition, Armenia has strengthened its banking sector by putting in place modern regulatory and supervisory frameworks.

Economic progress will depend on the continuation of the reform program, as well as positive political developments. Armenia's major impediment to development is the trade embargo imposed by two of its four neighbors – Turkey and Azerbaijan. This embargo will remain in place so long as there is no peace agreement with Azerbaijan that resolves the status of the Nagorno-Karabakh enclave. There has been a five-year cease-fire in the eight-year Nagorno-Karabakh conflict, but the potential for renewed conflict still exists and still dampens expectations.

At the same time, Armenia is firmly market oriented, with some of the most liberal trade legislation in the NIS. Armenia adopted the first private property law in the NIS in February 1996, and there is significant progress underway in such areas as land registration, energy and banking reform. Armenia's research and manufacturing industries, superior agricultural products, large pool of underemployed, but highly qualified, specialists, inexpensive labor force, and entrepreneurial spirit and close ties with the United States combine to offer attractive prospects for U.S. businesses. There are emerging investment and partnership opportunities, particularly in power generation, copper mining, construction, electronics, apparel, tourism, and food processing.

ECONOMIC OUTLOOK

Armenia's economy, growing for the last six years at an average of nearly 5%, has withstood considerable pressures since 1999. Inflation remains low at about 1% (1998-2000) and the exchange rate is stable, due in large part to a comfortable level of foreign reserves. Nevertheless, the public views the performance negatively: Armenians do not feel that they have gained much from this growth and they tend to be pessimistic about future economic prospects. Emigration, poverty, unemployment and inequality all remain extremely high. Recent social pressures have been a major source of both increased political instability and resistance to further reforms. However, it seems that the current growth may not be easily sustained without major structural changes to the economy and continued adjustments in economic policy. This is primarily indicated by: (a) low investment rate and thus weak ability to create new jobs; (b) low level of FDI; (c) low exports; (d) low rates of entry of new and restructured enterprises in core manufacturing; (e) an underdeveloped financial system; and (f) high income inequality.

Armenia's growth must be accompanied by greater generation, which is critical to re-establishing public trust in the Government's strategy and to halting the high rate of emigration. Reforms in the business and investment climate are now required, with emphasis on microeconomic issues and institution building in several core areas, including among others, social sectors. As seen in the EBRD's *Transition Report 2000* (pp. 13-131), key challenges remain while significant progress has been made.

Key Reform Challenges <ul style="list-style-type: none"> • With high fiscal and current account deficits, restoration of tax discipline is needed to maintain fiscal balance while safeguarding core public services. • After a year of paralyzing political uncertainty the reform process needs to regain momentum, including privatization of power distribution and measures to improve the investment climate. • Non-transparent or inconsistent regulation, gaps in the legal framework and uneven application of the rule of law impede investment and call for the accelerated institutional reforms. 	
Liberalization, stabilization and privatization	Enterprises, infrastructure, finance and social reforms
1991 Land reform begins (Jan.); Small scale privatization begins (May); Independence from Soviet Union (Sept.)	
1992 VAT introduced (Jan); Foreign trade registration abolished (Jan); Privatization law adopted (Aug); Central bank law adopted (Dec)	
1993 New currency (Dram) introduced (Nov)	1993 Stock exchange established (May)
1994 First privatization program adopted (Jan); Tradability of land permitted (Feb); Cease-fire in Nagorno-Karabakh (May); Voucher privatization begins (Oct)	
1995 Large scale privatization begins (Apr); Export surrender requirement eliminated (Apr); Most prices liberalized (July); Treasury bills market initiated (Sept)	1995 Bankruptcy law adopted (May); Foreign bank ownership allowed (June); Banking crisis peaked (Sept).
	1996 First foreign bank opened (Mar); Banking law amended (June); IAS audit of banking system (July)
1997 Full current account convertibility introduced (May); Major tax reform (May); First international tenders launched (Nov); new privatization law adopted (Dec).	1997 Bankruptcy law enacted (Jan); Energy regulatory commission established (Jun); Energy law adopted (Jun); Financial rehabilitation plan for the energy sector adopted (July); National telecommunications operator

	privatized (Dec).
1998 New customs law adopted (Dec).	1998 Telecommunications law adopted (Feb); Transport law adopted (Feb); IAS accounting for banks introduced (March); Law on accountancy (May) adopted; Securities and Exchange Commission established (Nov).
1999 New law on property rights adopted (Apr); EU partnership agreement (June)	1999 New poverty benefits system introduced (Jan); New civil code introduced (Jan); Increase in energy tariffs (Jan); New reserve requirements for commercial banks (Apr);
2000 European Parliament approves Council of Europe accession (June); Law on privatization of power distribution passed (July).	2000 New securities market law adopted (Jun); First private management of water utility (July).

These reforms have not been achieved easily. In 1997-2000 the process was affected by political resistance, insufficient government capacity in several areas, external shocks, and considerable delays in extending the World Bank's Enhanced Structural Adjustment Facility arrangements and disbursement of tranches of the third Structural Adjustment Credit to Armenia (SAC III). However, their continuation has offset, in many ways, the political uncertainties of late 1999 and early 2000 that adversely impacted the economy. Annual GDP growth in 1999 amounted to only 3.3%, as the crisis of confidence resulted in a drastic reduction of investment activity, delays in finalizing several large investment projects, and a serious deterioration in tax and revenue collection, particularly by public utilities. Privatization continued in 1999-2000 but at a slower pace; no major strategic privatization bringing in considerable foreign investment was finalized. Still, several medium-size privatizations were completed successfully in 2000, including those in the chemicals, electronics and diamond-polishing sectors. The recent failure of the Armenian Government to successfully privatize Armenia's electricity distribution companies (distco) will delay the World Bank's release of SAC IV. However, the Government has indicated that it still plans to successfully privatize the distco by the end of 2001 and will announce these plans at the Conference.

Overall, despite considerable external pressures, the macroeconomic situation has remained rather stable when compared to other low-income countries in the Former Soviet Union (FSU). Armenia's relative stability, liberal legal and tax regime, skilled work force, and natural beauty together with a large, international Diaspora facilitate direct investment in Armenia. Armenia's recent admission to the European Parliament underscores its reform efforts.

The Government recognizes the urgent need to facilitate private investment and growth and remains committed to adjusting its policies to eliminate distortions in the business climate and strengthen its capacity for investment promotion. Since

reviewing the obstacles to investment,¹ the authorities have set up a High-Level Business Council to support such reforms through a consultative process with the investor community. Actions taken to date in these areas are the focus of Government statements at the Conference.

In addition to investment, growth is expected from rising import demand in traditional markets (Russia and other countries of the FSU) as those economies recover, and from non-traditional markets, such as the Middle East and Western Europe. Export trend volatility reflects not only the specific nature of Armenia's main export products (e.g., jewelry and processed diamonds) but also private sector weakness and the instability of several of Armenia's major export markets. Strong export growth requires continued improvements in both the business environment and relations with Armenia's neighbors. Infrastructure investments to rehabilitate transport and communications linkages with neighboring countries will significantly facilitate growth in external trade and develop transit potential.

The ongoing conflict with Azerbaijan over the ethnic Armenian-dominated region of Nagorno-Karabakh and the breakup of the centrally directed economic system of the former Soviet Union contributed to a severe economic decline in the early 1990s. Recent progress in negotiations on the status of Nagorno-Karabakh provides some hope for a resolution of this conflict, which would further support political stability in Armenia and the whole region. Normalization of economic relations with its neighbors would bring major benefits to Armenia through lower investment risks, lower transportation costs, and stronger opportunities for trade and regional cooperation.

BUSINESS AND INVESTMENT CLIMATE

Armenian enterprises offer considerable potential – a technically skilled labor force and nearby export markets – to the Armenian Diaspora, as well as other strategic investors prospecting opportunities in the Former Soviet Union (FSU). In addition, where skilled labor adds value in technology-based supply chain – as in IT and software -- major international players have begun involving Armenian enterprises in their business plans to compete internationally.

Growing exports and foreign investments are helping to increasingly convert Armenian advantages into international profits, as reforms continue to offset the remaining adverse effects of past economic crises. Aided by the international community, reform efforts of the Government continue to stabilize the economy. With injections of small investments, Armenian enterprises are now poised to deliver strong, competitive international market performance. Locating and investing strategically in Armenia can help integrate larger FSU clients and markets, especially technology-based ones, into the global market place. Armenia's erstwhile position in the Soviet technology complex can be recaptured by infusing western competitive modes of production into FSU markets through Armenia. The experience of Pernod-Ricard and Yerevan Brandy Company illustrates this strategic vision in one non-technology area.

In the Soviet era, Armenia supplied both expertise and manufactured goods -- electronic equipment, machines, construction equipment, tools, optical and scientific instruments -- an internationally competitive technical-industrial skill set. The core human assets are available today, even while large state-owned infrastructures remain to be privatized and rejuvenated. Those that have privatized, such as an avionics supplier, Mshak Co., offer modern technology centers for world-class numerical control technologies for onward sales and services in FSU.

Structural Reforms Have Brought Business Gains and Offer New Directions

During the 1990s a series of economic shocks brought down what was the fourth-highest per capita income in Soviet Union to a meager per capita GDP of about 500 dollars. During the last few years, growth has been impressive, particularly in the construction sector. Initially, public skepticism over the sustainability of market reforms rose as household surpluses and investments in local companies shrank, the resulting liquidity starving their business plans. This discouraged entrepreneurship and risk-taking, leaving small- and medium enterprises (SMEs) competing for funds with infrastructure and privatization prospects. Now a number of them are at different stages of progress -- GEC Alsthom is proposing to install a gas-turbine facility at Yerevan Thermal Power Plant as international economic activity picks up. The Nairit chemical complex recently returned to profitability with improved marketing and expanding exports of synthetic rubber. Nevertheless, even though Austrian Airlines has just started flying to Yerevan, a world-class cargo terminal building at the Zvartnots airport lies vacant. The mining, smelting and food-processing sectors have recorded gains subsequent to irrigation, transport and energy sector projects and programs of the World Bank and the European Bank for Reconstruction and Development (EBRD).

Structural reforms have begun to take hold and to pass on economic gains to the business sector. Profits from successful fruit, vegetable and food processing operations now allow owners to divert some investment to newer technologies (e.g., Tetra-Pak and UHT, lengthening the shelf life of farm products) and ancillary operations. Nubar Goudsouzian, a Canadian Diaspora investor, started a tomato cannery -- Karmir Lolik -- with a few hundred thousand dollars and now expects to raise \$1.6 million from the EBRD to expand its market by meeting international and western food specifications. USDA and USAID have sponsored programs in agriculture, and most business infrastructure sectors have delivered IT, transport, energy and education-related assistance. In the energy sector, the privatization of distribution companies is expected to boost the service and ancillary cables, switching, and monitoring equipment industry. Tourism developments, following a construction boom, now offer increasing opportunities for its Diaspora to spend more time in Armenia. Investments in time-sharing town houses and bed and breakfast arrangements are being proposed.

Meanwhile, many skilled Armenians continue to emigrate, settling in Russia and elsewhere, hoping to remit cash wages. These problems of depleting human resources, especially in the IT sector, are compounded as enterprises get more isolated from regional and global markets. With only two open borders -- a short one with Iran (whose own international isolation renders it useless for further

trans-shipment of goods to the West) and another with Georgia (where civil strife in Abkhazia and South Ossetia limits the value of overland routes to the Black Sea) -- the price of transporting goods to international markets partially offsets the advantages of low wages and tariff reductions. The cost of inputs and capital goods so crucial to becoming internationally competitive will continue to rise if regional transportation arrangements offering lower-cost and assured timely delivery arrangements are not in place.

Overall, job opportunities and consumer demand remain depressed as SMEs cater to a tiny domestic market. To emerge out of stagnation and inefficiency they hope to acquire modern techniques, as well as new internationally competitive skills, by using production modes commensurate with marketing globally competitive goods and services. With this strategy, they expect to find new ways to overcome the business constraints they face. The Government is doing its part to reduce barriers, and the private sector looks eagerly to integrate with the West, launching Armenia in a new direction.

Business Investments – The Potential and Record

Armenian enterprises cannot easily forge equity links, strategic alliances, licensing arrangements, and R&D partnerships with neighboring countries. Exports represent about 20% of GDP, but have shown more promise recently. The Russian financial crisis of 1998 rapidly reoriented Armenia's foreign trade, making the EU its predominant trading partner -- but largely in cut diamonds. Overall, this is not sustainable. Manufactured and semi-manufactured goods that offer Armenia the most promise still encounter difficulties penetrating Western markets. Consequently, foreign investment of capital, technology and international trade networks to modernize them and their processes offers the maximum opportunity to enterprises. Although concessional loans and humanitarian assistance from the Diaspora have been significant, major investment of capital and technology into enterprises has not resulted. It has lagged behind most other FSU states and far behind others in Central and Eastern Europe.

The bulk of recent investments resulted from only a few transactions, of which the most significant one was the acquisition of Armentel by Greece's OTE. In spite of a dispute between OTE and the government over tariffs, and the resulting high costs of doing business for the IT sector, this was an advance in upgrading the telecommunications system critical for long-term development. Approximately 1,350 companies with foreign participation are registered in Armenia, with over 70 percent involved in trading activities. Multinational companies operating in Armenia include Coca-Cola, Huntsman, Marriott, ABB, Alcatel, Glaxo-Wellcome, HSBC, KPMG, and Pernod-Ricard. The annual foreign direct investment (FDI) during 1995-1997 ranged between \$20-50 million and total FDI reached \$500 million in January 2000, originating primarily from the Diaspora communities in the U.S., Russia, Iran, France, Greece, the UK, Germany, and Syria -- far below the full potential of available opportunities.

During the early 1990s, only a handful of U.S. firms came in each year but over 15 U.S. firms invested in 1995 alone. Later, as Procter & Gamble, M&M-Mars, Xerox, Dell, IBM and others began supplying the Armenian market, three major hotels --

the Armenia, the Yerevan, and the Ani -- were privatized and sold to American investors. In 1996, Marriott International was contracted to manage the Armenia Hotel; that same year, a Greek-owned Coca-Cola bottling plant began production. The American Armenian Exploration Company has spent over \$20 million on oil and gas exploration. An American-Armenian joint venture is upgrading wine and cognac production at the Ararat winery. Jermuk, an American-Armenian joint venture, produces one of the more popular brands of mineral water in Armenia. A number of projects, including electronic components, machine-made rugs, fruit juice processing and packaging, and the construction of hydropower plants, are currently in various stages of negotiation.

In general, modern-technology based infrastructure investments in which Western multinationals have already signaled an interest, such as telecommunications, software, electronics, medical diagnostics, food processing, and diamond cutting and polishing, testify to the appeal of Armenian enterprises. Western investors have recently given much attention to Armenia's software industry comparing it with India and Hungary for low-cost, high-quality code writers -- an asset conducive to the use of new Information Technology to overcome Armenia's geographic isolation. Larger scale investments, particularly those bringing modern means of adding a competitive edge to former Soviet-style modes of production and enterprise are essential if Armenia is to realize its potential.

Transparency Issues

The Government is aware that corruption and transparency issues are still serious barriers to business. For example, individuals in government positions are still engaged in private businesses and frequently use their influence to expand and project their enterprises, often in a way contrary to established international business practices.

One serious constraint is the lack of a transparent business, regulatory, and tax environment in part caused by a lack of accurate information (particularly in English). The new Civil Code, however, has been translated into English and is available at the U.S. Embassy, USAID, the library at the American University of Armenia, and other local libraries. Still, many of the business laws have numerous sub-regulations and norms that often change and are difficult to trace. Bureaucratic procedures may sometimes appear complex and confusing. Low-paid personnel of state agencies dealing with various business-related issues are often tempted to use the newcomer's limited knowledge of the local environment to ask for a fee to "speed up" even the simplest procedures. Cash "awards" for granting contracts, bank credits, well-paid jobs, and other forms of bribery are widespread.

To avoid these and other complications, the U.S. Embassy recommends that U.S. firms consult thoroughly with local lawyers on every aspect of their future activities in Armenia, including registration, licenses, taxes, particular tax incentives, local accounting principles, import/export procedures, certification requirements, contracts, etc. It is especially recommended for firms entering Armenia for the first time, and for those that have no Armenian partner. Firms are urged to carefully select an Armenian partner, and to adopt a long-term horizon regarding expected returns.

POLITICAL CLIMATE

Armenia's President is elected every 5 years. There were special elections for President held in 1998, after Levon Ter Petrossian resigned on February 3, 1998, over differences with his cabinet over the Nagorno-Karabakh peace process. These elections were carried out on a more peaceful note than were the 1996 presidential elections, thus improving the image of the country significantly. That image had been tarnished by the 1996 elections, when a number of incidents took place where both the opposition, which disagreed with the election results, and the Government resorted to violence.

Violence recurred in a tragic fashion on the floor of Parliament on October 27, 1999, as a gunman claiming the desire to save Armenia from corruption assassinated the Prime Minister and seven others.

The brother of the slain Premier, Aram Sargsian, took office and in his first speech to Parliament in November, had stressed that he would continue the policies of his predecessor regarding democratic development, economic policy, cooperation with international financial institutions, and the investment climate. Tensions between the new Premier and the President have been increasing since November, and ultimately led to the dismissal of the Premier for, according to Kocharian, "the government's inability to solve a series of social and economic issues." These tensions are bilateral, with some members of parliament calling for the impeachment of Kocharian.

On February 28, 2000, President Kocharian signed a decree reorganizing the government. The reorganization resulted in a decrease from 24 to 17 ministries. The President hopes this merging will help achieve success in improving the country's social and economic situation.

Armenia enjoys a particularly close relationship with the U.S. On a per capita basis, Armenia is the third largest recipient of U.S. aid. The United States Embassy was the first embassy to open in Yerevan, in February 1992. The Armenian Embassy opened in Washington in the same year. U.S. aid to Armenia emphasizes humanitarian assistance (food and fuel), building democracy and good governance, modernizing the banking system, fiscal reform, restructuring the energy sector, agricultural marketing, and creating a regulatory and a financial framework for private sector development. The United States is active in efforts to negotiate an end to the Karabakh conflict.

In the future, aside from the need for political stability at the top level of government, there are two primary political issues that will need to be resolved for Armenia to enjoy the benefits of an open, growing regional and global economy. The primary issue is the conflict surrounding Nagorno-Karabakh, an Armenian-populated autonomous enclave in neighboring Azerbaijan, which has lowered the attractiveness of investment in the region. Both sides have observed a cease-fire for more than 5 years. There is, however, no indication that the embargoes will be lifted in the near future. Although international efforts aimed at settling this conflict are ongoing.

The second issue, related to the Nagorno-Karabakh territorial dispute, is the role of Turkey. Turkey has sided with Azerbaijan in this conflict and has established a

blockade of Armenia, paralleling that of Azerbaijan. The embargoes have lost a small amount of their economic influence because many Turkish goods and Azeri oil products find their way to Armenia anyway, albeit at much higher prices. Also, since 1995, Turkey has allowed a limited number of passenger charter flights between the two countries as well as Armenian transit flights over Turkish territory. The embargo remains one of the key factors hindering economic development of Armenia. The embargo also ties the hands of many U.S. businesses whose regional headquarters (which usually cover the Caucasus) are in Turkey. There is some room for optimism however, because traditional demands on former Armenian lands in Turkey have subsided.

SOURCES OF FINANCING

Armenia's banking sector has two large state-controlled banks (Savings Bank and Ardshinbank) and 29 private commercial banks with over 220 branches. HSBC, Rossiyski Kredit Armenia (Russia), and Mellat Bank (Iran) represent foreign banks. The number of private banks has been slowly declining because the Central Bank has pursued a policy of tightening bank capitalization requirements to push the weak banks into closing or into mergers with stronger banks. The increased requirements and competition force the banks to begin to meet international standards. Consequently, remaining banks are considerably stronger and are subject to close supervision.

The Government has created a legislative environment to encourage the growth of the private insurance market. Marine Midland has opened a commercial insurance subsidiary that is now doing business in the country.

Lending from most private banking institutions is limited by their low capacity (very few banks can provide loans exceeding \$20,000). At present, many private banks limit their lending operations to short-term loans in local or hard currency at a very high rate of interest (up to 6-9% per month, or 50-70% per annum). These banks usually demand collateral of adequate or higher market value (homes, cars, gold, etc.).

The banking situation, however, is beginning to change. Marine Midland, for example, is now lending on 1- to 2-year terms to about 40 enterprises at more affordable interest rates. It is unclear, however, how fast this financial deepening of the economy will proceed, and especially in light of the economic problems now being experienced by Russia, Armenia's main export market.

Project financing is still limited and is primarily implemented through subsidized loan programs funded by foreign governments and multilateral financial institutions. The programs are aimed at private business development for specific categories of enterprises. They are serviced by a few local banks and offer loans ranging from \$500 to \$500,000 with, on average, 15-20% annual interest. The loans are normally supported by a business plan and are secured by adequate collateral.

The best sources of export and insurance financing are from the U.S. Export-Import (Ex-Im) Bank and Overseas Private Investment Corporation (OPIC). In July

1997, the Ex-Im Bank signed a General Project Incentive Agreement with Armenia that provides a framework for financing the purchase of U.S. exports, with the loans to be repaid with hard currency revenues generated by production from the enterprises buying U.S. goods or services.

At present, mainly the IFC, EBRD, USAID, OPIC, and TDA (feasibility studies) provide financing for projects in Armenia. Most projects financed by international institutions, such as the World Bank or EBRD, are contracted on an international tender basis.

SECTORAL OVERVIEWS

Good prospects exist for U.S. firms wishing to purchase or privatize idle enterprises and laboratories of the electronics industry. The availability of a local labor force skilled in the operation of hi-tech equipment, electronics and software programming represent good business opportunities for U.S. companies wishing to develop or assemble their products (televisions, VCRs, computers, and peripherals) in Armenia for subsequent export to third countries. The active sub-sectors include chip testing, telecommunications, Internet applications, and stock market data processing.

TELECOMMUNICATIONS

Telecommunications services in Armenia, including satellite connections and the Greek-Armenian Company Armentel provides Internet services. Ninety percent of Armentel's shares belong to Greece's state-owned telecommunications company OTE for which it paid US\$142.5 million, with the remaining 10 percent belonging to the government of Armenia. In 1997, the company was licensed by the Ministry of Communications of Armenia and given 15-year monopoly rights on international telecommunications services in the country. Armentel itself sets tariffs for the use of satellite channels. Basic tariffs are set in the license agreement that gives Armentel the monopoly rights. Because of the monopoly, no other company is able to provide international satellite services. The EBRD is planning to purchase a 9% stake in Armentel by paying US\$17.6 million. This deal may reduce the mobile phone and data transmission monopolies to 5 years.

Armenia's telecommunications network is outdated. Currently, Armentel is upgrading the country's telephone network by installing new digital telephone stations.

Armenia has about 650,000 telephones; average telephone density is 17.7 per 100 persons; international connections to other former republics of the USSR are by landline or microwave, and to other countries by satellite and by leased connection through the Moscow international gateway switch. Broadcast stations: almost 100% of the population receives Armenian and Russian TV programs (some areas also receive Turkish, Iranian, Georgian, and Azerbaijani TV broadcasts). Private TV

broadcasting stations, cable networks, and Internet providers are increasing in number.

INFORMATION TECHNOLOGY

Armenia offers attractive investment opportunities to software developers. There are a growing number of local software companies. Several U.S. firms have already started successful software projects in Yerevan, Armenia's capital, employing Armenian programmers and using the benefits of qualified and low cost labor. A number of Armenia-based programmers also work for U.S. companies' headquarters via the Internet. While local Armenian companies primarily serve the limited internal market, the American companies have exploited the export niches, developing software for international markets. The country possesses a significant number of programmers, most of who are graduates from the state University of Armenia and the State University of Yerevan and the Yerevan Engineering University. Many of these programmers worked for the defense industry in the past. The industry currently employs over 300 programmers, of which almost 100 are employed by HPL Armenia, a subsidiary of the Silicon Valley-based Heuristics Physics Labs, Inc. HPL has become the largest software firm in Yerevan. There are also 10 other large companies engaged in software development. The products include educational, financial, industrial, scientific, management, and other software packages.

The high skill levels of Armenian programmers and low cost of research and development in Armenia are the main driving factors for U.S. software developers. Existing subsectors include chip testing, telecommunications, Internet applications, and stock market data processing.

In terms of Internet services, the primary Internet providers in Armenia are Arminco and Infocom. Both these local companies use Armentel's satellite channels for connecting to the Internet. There is a growing number of Internet users in both the residential and business sectors. Due to inconsistent service, the potential exists for competitors of Arminco and Infocom to enter the market.